

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 06-0206
Use Tax for 2004

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ISSUE

I. Use Tax—Assessment on Purchase of Aircraft

Authority:

IC 6-8.1-5-1(b); IC 6-2.5-3-2; IC 6-2.5-3-6(d)(2); IC 6-2.5-1-2; IC 6-2.5-1-5; IC 6-2.5-1-27; IC 6-2.5-2-1; IC 6-2.5-2-2; IC 6-2.5-4-1; IC 6-6-6.5-8; IC 6-6-6.5-10.4; IC 6-2.5-5 *et seq.*; IC 6-2.5-3-4; IC 6-2.5-5-8(b); IC 6-2.5-4-10(a); Indiana Dept. of State Revenue v. Interstate Warehousing, 783 N.E.2d 248 (Ind. 2003).

Taxpayer protests the assessment of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer owns an aircraft purchased from an Indiana aircraft dealer. After purchasing the aircraft, Taxpayer entered into a marketing agreement with the aircraft dealer. In the agreement, the aircraft dealer—identified and named as an agent of Taxpayer—entered into an arrangement to serve as Taxpayer's non-exclusive marketing and compliance agent. The agent would rent the aircraft to qualified licensed pilots on an hourly basis.

Taxpayer is a wholly-owned subsidiary of a parent company LLC. Taxpayer is a disregarded entity for federal tax purposes. Taxpayer entered into an hourly rental agreement with the parent LLC to rent the aircraft to the parent LLC.

Taxpayer registered the aircraft with the Department and claimed an exemption from sales and use tax on the ground that it intended to rent or lease the aircraft to others. The Department requested documentation from Taxpayer to substantiate the basis of the exemption. Upon review of the documentation, the Department denied Taxpayer's exemption claim and issued an assessment for use tax. Taxpayer protested the denial of the exemption claim and the use tax assessment. A hearing was held and this letter of findings results.

I. Use Tax—Assessment on Purchase of Aircraft

DISCUSSION

All tax assessments are presumed to be accurate; the taxpayer bears the burden of proving that an assessment is incorrect. IC 6-8.1-5-1(b).

In September 2004, Taxpayer purchased an aircraft and named itself as the owner on Form 7695, "APPLICATION FOR AIRCRAFT REGISTRATION OR EXEMPTION." IC 6-2.5-3-2 imposes an excise tax, commonly known as the use tax, on the storage, use, or consumption of an aircraft if the aircraft (1) is acquired in a transaction that is an isolated or occasional sale; and (2) is required to be titled, licensed, or registered by this state for use in Indiana. In the case of aircraft, taxpayers pay the tax directly to the Department when registering the aircraft—unless the aircraft qualifies for an exemption. IC 6-2.5-3-6(d)(2).

When an aircraft is purchased from an Indiana aircraft dealer, the dealer collects sales tax from the purchaser. Every aircraft dealer making a sale of an aircraft required to be licensed in the State of Indiana must complete a Form ST-108AC and must send the original to the Department. Form ST-108AC is a summary of the transaction and requires that a description of the aircraft purchased and any aircraft traded in. The forms requires the computation of the amount subject to sales or use tax. The aircraft dealer completed Form ST-108AC on Taxpayer's purchase of the aircraft. In the section computing the amount subject to sales or use tax, the aircraft dealer entered \$297,500. In next section stating the amount of sales or use tax collected from the purchaser, the aircraft dealer entered "exempt."

Because Taxpayer purchased the aircraft from a dealer, Taxpayer was required to pay sales tax to the dealer for remittance to the State of Indiana as required by IC 6-2.5-1-2, IC 6-2.5-1-5, IC 6-2.5-1-27, IC 6-2.5-2-1, IC 6-2.5-2-2, IC 6-2.5-4-1, IC 6-6-6.5-8, and IC 6-6-6.5-10.4.

Exemptions to sales and use tax exist. *See* IC 6-2.5-5 *et seq.* and IC 6-2.5-3-4. IC 6-2.5-5-8(b) exempts from sales and use tax, property acquired for resale, rental, or leasing in the ordinary course of the person's business. The Indiana Supreme Court has stated:

It is well established that exemption statutes are strictly construed against a taxpayer so long as the intent and purpose of the Indiana Legislature is not thwarted. As such, a taxpayer has the burden of establishing its entitlement to an exemption.

Indiana Dept. of State Revenue v. Interstate Warehousing, 783 N.E.2d 248, 250 (Ind. 2003).

When Taxpayer filed Form 7695 to register the aircraft with the State, it claimed in Section D a sale and use tax exemption for "Rental or Lease to others." IC 6-2.5-4-10(a) states that the rental or leasing of tangible personal property to another person is a retail transaction. In accord with IC 6-2.5-2-1, sales tax is to be imposed on the rental of the aircraft by Taxpayer to others. This means that sales tax is to be charged and collected from lessees when it uses Taxpayer's aircraft.

Taxpayer claims it is entitled to a sales and use tax exemption because it is engaged in the rental of the aircraft to others in the ordinary course of its business. This claim requires an analysis of the substance and form of Taxpayer's rental agreement with its parent company and the marketing agreement with the aircraft dealer.

The parent company and its officers and employees have a need for an aircraft. Taxpayer has stated that it is a disregarded entity. Taxpayer states that the Taxpayer's parent LLC includes Taxpayer in the parent LLC's federal partnership 1065 return. Taxpayer has stated that the aircraft's expenses are attributed to the parent LLC and the revenues are attributed to Taxpayer.

Taxpayer and the parent company have common officers and employees. The circumstances suggest that Taxpayer is renting the aircraft to itself. While the form of the transaction may be structured as a lease to others, because Taxpayer is a disregarded entity and because the expenses are attributed to the parent LLC and the revenues attributed to Taxpayer, the transaction can be interpreted as a lease arrangement with itself—not rental or lease to others. Taxpayer has acknowledged that the "rental" is to a "related party company."

At the hearing Taxpayer submitted a folder with information to support its protest. On the sheet entitled, **"COLLECTION AND REMITTANCE OF SALES TAX ON RENTALS"** Taxpayer states:

Sales tax has been collected and remitted for all revenues generated by the leasing of the subject aircraft. Flights representing use by [aircraft dealer with whom Taxpayer has a marketing agreement] are billed to the customers of [aircraft dealer] and [aircraft dealer] collects and remits the sales tax on those flights. Rental revenues from [Taxpayer's parent LLC] are collected by [Taxpayer] and [Taxpayer] collects and remits sales tax to Indiana on all those flights. Any revenues from the personal use of the aircraft by [Taxpayer's officer] are also computed at fair market value by [Taxpayer] and [Taxpayer] collects and remits sales tax to Indiana on those flights as well. Copies of all sales tax returns are included herewith. Sales taxes remitted to Indiana for [Taxpayer's] rental of the aircraft to [Taxpayer's parent LLC] and or [Taxpayer's officer] were as follows:

...

Taxpayer has remitted some sales tax to Indiana for the use of the aircraft by Taxpayer's parent LLC and the personal use by Taxpayer's officer. However, the Department has not received the sales tax for the transactions handled by Taxpayer's agent, the aircraft dealer. Within the folder, Taxpayer included a sheet entitled, **"USE OF AIRCRAFT"** that states 89.11 percent of the use of the aircraft consist of rentals by its agent. Taxpayer categorizes 89.11 percent activity as rental and leasing to others: the aircraft dealer. Assuming *arguendo* that the aircraft dealer can be considered a third-party lessee, Taxpayer would need to collect and remit sales tax for the use of the aircraft by the aircraft dealer. Taxpayer has provided the Department an exemption certificate given to Taxpayer by the aircraft dealer, claiming rental and leasing to others. However, the Department cannot accept the certificate as justifying the failure to collect and remit sales tax on these transactions; the aircraft dealer is not a third-party lessee, but is Taxpayer's agent. The sales tax needed to be collected and remitted in Taxpayer's name in order to document and substantiate Taxpayer's business transactions.

Taxpayer's marketing agreement with the aircraft dealer states that the aircraft dealer is an agent of Taxpayer, using the term "Agent" to identify the aircraft dealer. The agreement states that "Agent in the ordinary course of business develops relationships with prospective customers for owner seeking to rent aircraft." These are "customers for owner." According to the agreement, the owner—Taxpayer—is to keep the aircraft maintained at Taxpayer's own expense. Costs for fuel and oil consumed operating the aircraft are to be paid by the owner, Taxpayer. Registration fees, taxes, and insurance are to be paid by the owner, Taxpayer. The agreement states that the aircraft is the sole exclusive property of the owner, Taxpayer. It is a reasonable interpretation of the agreement to conclude the agent—the aircraft dealer—does not rent the aircraft from Taxpayer, but provides services and secures customers for Taxpayer. For this reason, the

Department expects that sales tax collected from the customers secured by Taxpayer's agent are remitted to the Department in Taxpayer's name.

Taxpayer has provided the Department with invoices showing that the agent collected sales tax on rental transactions. What the Department cannot verify is that this sales tax has been remitted on Taxpayer's behalf. Because Taxpayer has not substantiated rental and leasing to others, evidenced by the collection and remittance of sales tax on those transactions, the sales and use tax exemption on Taxpayer's purchase of the aircraft is denied.

FINDING

For the reasons stated above, Taxpayer's protest is denied .